Finansinspektionen’s Regulatory Code

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Finansinspektionen’s regulations regarding subordinated loans in an insurance companies' own funds;

decided on 2 April 2007.

Finansinspektionen hereby prescribes the following pursuant to section 49 of the Insurance Business Ordinance (1982:790).

Chapter 1 Scope and definitions

Section 1 These regulations apply to insurance companies which apply for or have been granted approval by Finansinspektionen to include subordinated loans in their own funds.

Section 2 In these regulations the terms and expressions shall have the following meanings.

Required solvency margin: The solvency margin or the guarantee amount, whichever is the higher.

Perpetual subordinated loan: Subordinated loans with no fixed term.

Subordinated loans: A loan with conditions stating that in the event of liquidation or bankruptcy the loan receivable, in terms of both capital and interest, shall be paid only when the other creditors have been paid.

Own funds: Own funds in accordance with chapter 7, sections 22, 24 and 24a of the Insurance Business Act (1982:713).

Solvency margin: The lowest capital requirement calculated on the basis of the nature and scope of the activity in accordance with chapter 7, sections 23 and 25 of the Insurance Business Act. (In this context: the greater of the solvency capital requirement and the minimum capital requirement)

Step-up conditions: Conditions in the loan agreement which state that the interest rate or the margin will rise after a certain time.

Step-down conditions: Conditions in the loan agreement which state that the interest rate or the margin will fall after a certain time.

Fixed-term subordinated loan: Subordinated loans with a fixed term.

Chapter 2. Applications

Section 1 An insurance company, in its application for approval to include subordinated loans in its own funds in accordance with chapter 7, section 22 or 24 of the Insurance Business Act (1982:713), shall state

– the purpose of the subordinated loan,
– own funds and required solvency margin, both including and excluding subordinated loans, and
– what changes in the own funds and required solvency margin the company anticipates over the next three years.

In its application, the company shall also attach an agreement for the subordinated loan and supporting documents for assessment of interest conditions.

Chapter 3. Maximum proportion that may be included in own funds, etc.

Section 1 Subordinated loans may be included in own funds at a maximum of 50 per cent of the own funds or the required solvency margin, whichever is the lower. A maximum of 25 per cent of own funds or the solvency margin, whichever is the lower, may consist of fixed-term subordinated loans.

Section 2 Subordinated loans may be included in own funds only insofar as they are fully paid.

Section 3 Subordinated loans may be included in own funds only if the insurance company has not provided security for the loan.

Chapter 4. Conditions to be stated in the loan agreement

Section 1 In order for Finansinspektionen to permit a subordinated loan to be included in own funds, the loan agreement must meet the requirements set out in this chapter.

Common conditions for perpetual and fixed-term subordinated loans

Section 2 The terms of the agreement shall state that the subordinated loan has a subordinated payment right.

A *subordinated payment right* means that if an insurance company goes bankrupt or goes into liquidation, the subordinated loan capital, with its associated deferred and accrued interest, has priority after all the remaining creditors' claims and that it is not paid out before all other debts outstanding at that moment have been settled.

If there is more than one subordinated loan, the holder of a fixed-term subordinated loan is entitled to receive payment before the holder of a perpetual subordinated loan. In terms of the right of priority, a subordinated loan may be compared with other subordinated loans (pari passu) with the same term structure.

Section 3 The subordinated loan agreement may be amended only if Finansinspektionen has granted permission for such an amendment.

Section 4 The loan agreement shall specify the applicable model for calculation of interest. Interest may be fixed or related to a base interest rate. A fixed-term subordinated loan may also be granted as a discount instrument.

If the loan agreement contains step-up conditions, such a condition may not mean that the interest or the margin will rise by over 1.5 percentage points during the full term of the loan.

Section 5 The loan agreement shall state that the insurance company may defer payment of the interest if own funds are below or there is a risk that they may fall below the required solvency margin due to such a payment.

Interest may be paid on the deferred amount of interest in accordance with the provisions of the loan agreement and may at most be three percentage points above the interest that otherwise applies to the loan.

Specific conditions for perpetual subordinated loans

Section 6 The loan agreement shall state that a perpetual subordinated loan shall have an indefinite term.

Section 7 The terms of a perpetual subordinated loan agreement shall state that the creditor has a right to payment only if the insurance company has been declared bankrupt or gone into liquidation.

Section 8 In order for a perpetual loan to fulfil the requirement for an indefinite term, step-down conditions may not mean that the interest is illogically high at the beginning of the term of the loan only to then fall drastically.

Section 9 A perpetual subordinated loan may be repaid after Finansinspektionen has granted permission in response to an application by the insurance company. An application for a permit for settlement shall be made no later than six months prior to the date when settlement is intended to take place. In its application, the insurance company shall report on own funds and the required solvency margin both before and after the repayment. Furthermore, the company shall state what changes in own funds and the required solvency margin the company anticipates over the next three years.

One prerequisite for Finansinspektionen to approve a settlement of a perpetual subordinated loan is that the insurance company's own funds are satisfactory in the long term and will not thereby fall below the required solvency margin.

Section 10 An insurance company's subsidiary company may acquire a perpetual subordinated loan issued by the insurance company only after Finansinspektionen has granted permission.

Specific conditions for fixed-term subordinated loans

Section 11 Fixed-term subordinated loans shall have an original term of a minimum of five years. The insurance company shall, no later than one year prior to the due date, submit a plan to Finansinspektionen for how own funds may be maintained at a level higher than the required solvency margin or increased to the required solvency margin when the loan falls due for payment. Finansinspektionen shall approve the plan.

The insurance company need not submit a plan if the proportion of own funds accounted for by the perpetual subordinated loan has gradually fallen over the five years prior to the due date and the subordinated loan is therefore no longer included in the own funds at the due date.

Section 12 The loan agreement may not contain conditions that mean that the subordinated loan may fall due prior to the agreed due dates.

Section 13 . A fixed-term subordinated loan may be repaid prior to the due date after Finansinspektionen has granted permission in response to an application by the insurance company. In its application, the company shall report on own funds and the required solvency margin both before and after the repayment. Furthermore, the company shall state what changes with regard to own funds and the required solvency margin the company anticipates over the next three years.

Section 14 If an insurance company has issued a fixed-term subordinated loan with a right for the company to settle the loan prior to the due date, the earliest possible repayment date (the call date) forms the basis for calculating the term of the loan.

Section 15 If a fixed-term subordinated loan is extended, it shall be regarded as a new loan. The residual term shall after the extension be at least five years in order for the loan, after the extension, to be included in own funds. An insurance company that wishes to be able to include a subordinated loan that has been extended in its own funds shall submit an application to Finansinspektionen to that effect.

Section 16 Fixed-term subordinated loans may only be repaid and amortised if Finansinspektionen considers that the insurance company's own funds are satisfactory in the long term and are not below and do not risk falling below the required solvency margin due to such a payment. Otherwise, repayment may not take place unless the loan is replaced by at least a corresponding amount of capital of the same or higher quality.

How a subordinated loan can be used for continuous coverage of losses

Section 17 The loan agreement shall state that accrued interest, deferred interest and the principal can be appropriated to cover losses so that the insurance company is given the opportunity to continue operating without needing to go into liquidation or be declared bankrupt or, in the case of a mutual insurance company, call for funds from policyholders.

Losses may be covered by writing down the accrued interest and deferred interest on a subordinated loan, followed by the principal of the subordinated loan. Perpetual subordinated loans shall be appropriated before fixed-term subordinated loans.

Section 18 When an amount is appropriated in accordance with section 17, it shall be irrevocable and final. Provisos regarding the right of lenders to future payment may only cover cases in which the restitution of the appropriated amount can be made from distributable profits in accordance with an adopted balance sheet.

Section 19 The loan agreement shall state that an insurance company which is liable to go into liquidation in accordance with a balance sheet for liquidation purposes may appropriate all or part of a subordinated loan, including accrued interest, in order to restore shareholders' equity.

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1. These regulations shall enter into force on 1 May 2007, whereupon Finansinspektionen's general guidelines (FFFS 1998:15) regarding the possibility for insurance companies to include subordinated loans in their own funds shall be repealed.

2. Nevertheless, the provisions contained in chapter 4 on the conditions to be stated in the loan agreement do not apply to subordinated loans which, pursuant to an approval from Finansinspektionen, are included in own funds when these regulations enter into force.

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